

Airline Cost-Cut Targets: Are Airport Fees Next? By Louis D. Wolinetz

Airports have shown substantial financial stability during the turbulent business climate of the past five years even as their primary partners, airlines, have struggled. A report by Fitch released in October 2004 found that credit ratings for U.S. airports are largely unchanged since 2000. Without exception, airports continue to garner investment-grade ratings, and to date there has never been a default on a U.S. airport bond. In contrast, the list of investment-grade, major passenger carriers consists of a single company—Southwest Airlines—and airline bankruptcies are regular news.

Airlines have aggressively cut costs, with much attention focused on labor costs. However, rapidly rising fuel prices have offset these cuts, leaving carriers looking for new ways to reduce expenses. Although airline fees charged by airports have historically represented only a modest percentage of airline expenses, carriers will be increasingly looking to airports to hold the line on costs.

Cost per enplaned passenger (CPEP) is a measure of total airside and landside fees carriers pay for operating at a given airport divided

by passengers boarded. It includes landing fees, airside usage charges, terminal rents and other fees charged to airlines. Eighteen months ago in this space (*AM*, September/October 2003, p. 78) we looked at the factors affecting CPEP. That article found four key CPEP drivers: southern airports with lower cost of living and warm climates, residual airline agreements, non-airline revenue generation and low debt were all linked to low CPEP.

This article examines CPEP over the past five years to determine if airports should be concerned about rising CPEP. Data for this analysis is primarily based on FAA Form 127 reports from 2000 through 2004. While the numbers shift slightly from year to year, about 32 large hub, 36 medium hub, and 70 small hub airports are included. Data from only about half the airports was available from 2004. In addition, data from airline annual reports is presented to demonstrate the impact of CPEP on major carriers.

CPEP on the rise

Typical CPEP for airports of all hub sizes has been on the rise over the past five years, as shown in Figure 1

(Fig. 1). Rising CPEP is not surprising, given the downturn in enplanements after 2001 due to a weakening economy and fears of terrorism. According to FAA data, nationwide enplanements fell from 709 million in 2000 to a low of 644 million in 2002. Furthermore, new burdens such as meeting TSA security requirements caused airports to increase expenditures, while many airport capital programs, especially at larger airports, were planned or underway prior to the traffic downturn. Debt for these projects typically increases CPEP (often with the airlines' blessing). These effects are apparent in the data, which shows significant increases in CPEP for all hub sizes after 2002.

Perhaps less expected, the median CPEP increased far more rapidly at larger airports. CPEP was similar in 2000 for all three hub sizes, ranging from \$4.74 at small hubs to \$4.94 at large hubs. Since 2004, however, CPEP increases at large hub airport have doubled those at small hubs (rising 43 percent and 21 percent, respectively) and outpaced medium hubs, where CPEP rose 27 percent. One explanation for this is that large hub

Table 1 CHANGE IN OPERATING COSTS AND NON-AVIATION REVENUE, 2000-2004

	Median % Change Operating Cost	Median % Change Non-Aviation Revenue
Large Hubs	56%	44%
Median Hubs	35%	19%
Small Hubs	-2%	17%

Fig. 1 MEDIAN COST PER ENPLANED PASSENGER (CPEP) 2000-2004

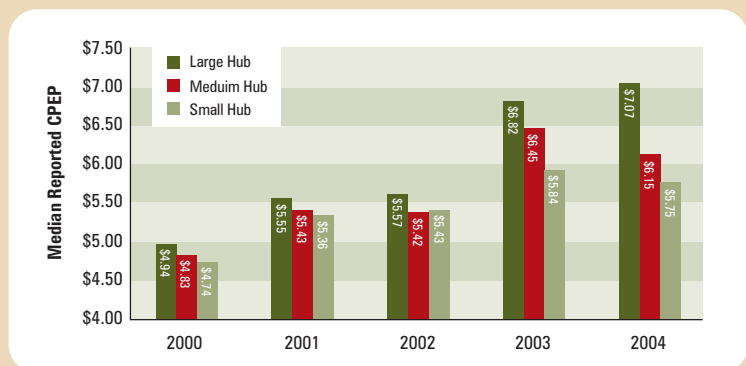


Fig. 2 LEGACY CARRIER AIRPORT FEES PERCENTAGE OF OPEX

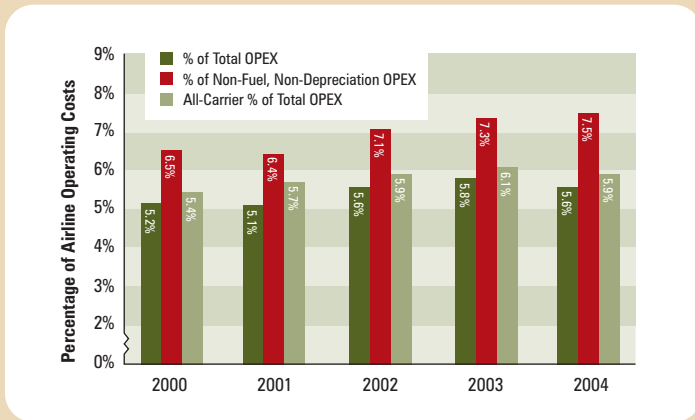
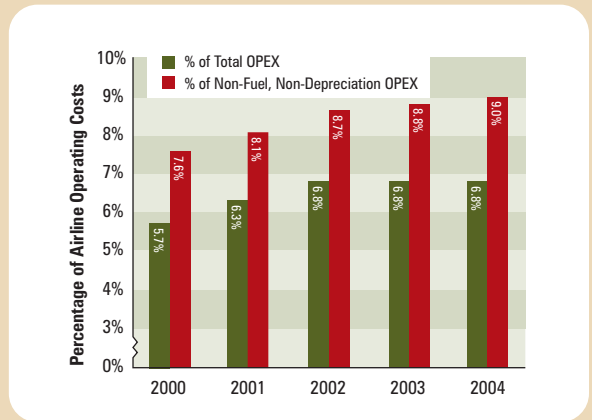


Fig. 3 LOW-COST CARRIER AIRPORT FEES PERCENTAGE OF OPEX



airports, situated near major cities and often without significant competition, retain a measure of pricing power that smaller airports many not enjoy. Small airports are more likely to face reduced service if costs rise.

Generating non-airline revenue from parking, retail and food concessions, rental cars and land rentals help airports hold the line on airline fees. Our analysis found that airports of all sizes have been successful in increasing non-airline revenues, even as passenger numbers dipped. Median non-airline revenue collections rose 44 percent from 2000 to 2004 at large hub airports, and rose 19 percent and 17 percent at medium and small hub airports, respectively (see Table 1).

The bad news is that operating costs at large and medium hub airports have increased far faster than non-airline revenues during the study period, rising 56 percent at large hubs and 39 percent at medium hubs. This indicates that the percentage of total airport operating costs covered by airlines has increased substantially, leading to the need to increase CPEP. Small hubs saw increases of 18 percent through 2003 before dropping back in 2004 to a level similar to 2000.

At first glance, it appears that rising airport fees are not causing a major impact to airlines' bottom lines. Our analysis of SEC Form 10-k data from eight airlines (American, United, Delta, Northwest, Continental, Southwest, JetBlue, and AirTran) found that air-

port fees represented 5.9 percent of airline operating costs (OPEX) in 2004, up only marginally from 5.4 percent in 2000 (Fig 2). A deeper look, however, reveals that these fees are having an effect.

First, airline fees are consuming an increasing percentage of OPEX of low-cost carriers (LCCs). The three LCCs in our sample saw median airport fees rise from 5.7 percent of total OPEX to 6.8 percent in 2004, a jump of more than 19 percent (Fig. 3). This suggests that carriers that have been most successful in holding down other costs may become increasingly concerned with rising CPEP.


Second, airport fees comprise an increasing share of controllable costs for legacy carriers as well as LCCs. Aircraft fuel costs, traditionally the second largest airline cost after labor, have reached record levels. Since fuel costs cannot be controlled by airlines, it makes sense to look at airport charges as a percentage of OPEX excluding fuel. Depreciation was also removed, since it is a non-cash cost.

This analysis found that airport fees represent 8 percent of non-fuel, non-depreciation costs (NFND costs) for the eight carriers studied, up from 7 percent in 2000. Once again, it is the LCCs which have seen the biggest increase, with airport charges comprising 9 percent of NFND costs in 2004 compared to 7.6 percent in 2000. At this level, airport charges may begin to attract more attention from LCC executives.

Cause for concern?

Airports have become highly cost-conscious during the market fluctuations of the past five years, improving efficiency, increasing non-airline revenues and even delaying capital programs. Despite these efforts, CPEP has been rising steadily, and comprises an increasing portion of airline operating costs.

For carriers, cutting costs is a requirement for survival. With labor costs in many cases cut to the bone and fuel expenses spiraling upward, any cost category that is increasing is a cause for concern. As a small but rising part of airline OPEX, more attention may be paid to CPEP in the future.

The implications for airports might include tougher negotiations for new airline agreements, more skepticism about capital programs and increased pressure to generate non-airline revenues. This heightens the need for airports to work closely with their airline business partners to ensure that they understand the future vision of the airport and that they are working together to achieve it. 

How does this experience compare to your airport? If you would like to share your ideas and information, please e-mail lwolinetz@imggroup.com.

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